Ravi Menon: China-Singapore financial connectivity

Speech by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the 2nd RMB Internationalisation Summit, Singapore, 7 June 2016.

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Mr Jiang Jianqing, former Chairman of Industrial and Commercial Bank of China

His Excellency Mr Chen Xiaodong, Ambassador of the People's Republic of China to Singapore

Distinguished guests, ladies and gentlemen, good morning.

I am happy to join you and would like to thank ICBC for the invitation.

China's economic transformation

China's economy is at a major inflection point, balancing three objectives.

- First, to manage a moderation in its economic growth without undue disruption.
- Second, to resolve vulnerabilities in its economy and financial system without triggering a crisis of confidence.
- Third, to implement perhaps the most comprehensive and ambitious structural reform programme of any country in modern times.

In the short term, these three objectives may at times be in conflict, presenting a trilemma of difficult trade-offs for policymakers. But if successfully executed, they are mutually reinforcing and will lay the foundation for a more sustainable and vibrant economy.

China's economic restructuring has deep implications for Asia. A new configuration - a new regional value-chain - is taking shape across the region, driven by three features of China's economic transformation.

First, China is shifting from a labour-intensive industrial structure to a more skill and technology-intensive one.

- China is inshoring more high value-added production within China. This obviously poses challenges for competing high value-added producers in Asia.
- But China is also offshoring lower value-added, labour-intensive production. This creates opportunities for the less-developed regional economies to catalyse their own industrialisation.

Second, China's import composition is shifting in favour of consumer goods and services.

- The more developed economies in the region are well-positioned to tap into China's demand for financial services, healthcare, education, and tourism.

Third, China is emerging as a significant source of capital for the region.

- In the middle of last year, while the world's attention was focused on the volatility in China's financial markets, an important development took place that went largely unnoticed.
- China became, for the first time, a net exporter of direct investment.
- Chinese FDI in ASEAN has been increasing by an average of 25% every year, in the five years to 2014.

Vietnam and Cambodia are examples of countries that have become more plugged into the global markets as a result of becoming part of this new regional value chain.

- Vietnam has emerged as a key assembly hub for electronic and electrical products.
- Cambodia has become a manufacturing base for Chinese garment and footwear companies, with three-quarters of its garment and footwear exports in 2014 headed for Europe and the United States.

Future of RMB internationalisation

China has embarked on the formidable task of liberalising the capital account at a time when domestic growth is slowing, its financial system is still maturing, and US monetary policy is normalising. The process has therefore entailed careful calibration and periodic reassessment – crossing the river by feeling the stones.

Since 2010, the offshore RMB market has experienced remarkable growth, driven by strong investor appetite and cross-border trade. In the near term, however, the trajectory of RMB internationalisation is likely to moderate, due to a confluence of factors.

First, global trade, which is a key factor driving the overseas use of the RMB, has declined.

- Merchandise trade flows between China and its trading partners are expected to be modest in the next year or so, reflecting cyclical headwinds.

Second, market expectations of China's GDP growth affect expectations of the RMB's appreciation or depreciation.

- As the Chinese authorities forge ahead with fostering a more market-based RMB exchange rate, greater two-way volatility can be expected, compared to what appears to have been a one-way trend appreciation in the past.
- This could have a bearing on investors' expected returns on RMB deposits and financial assets, and therefore their demand for offshore RMB.

Third, the liberalisation of China's capital account is likely to proceed cautiously in the near term.

- Policymakers will be more cautious in the short-term as they work to ensure that the market volatility and ensuing capital outflows in late 2015 and early 2016 do not have a lasting impact on market confidence.

But I believe the Chinese authorities remain committed to liberalising the capital account and promoting the international use of its currency in the medium term.

- The latest 13th Five-Year Plan, announced in March this year, has made clear the aim to reduce foreign exchange restrictions for both corporates and households and encourage the use of the RMB in cross-border payments and international reserves.

Progress in RMB internationalisation will ultimately depend on getting right the sequencing of domestic economic and financial reforms. A strong and stable domestic financial system is a prerequisite for further capital account liberalisation and currency internationalisation.

China-Singapore financial connectivity: the journey so far

Singapore's financial linkages with China have grown strongly over the years, particularly since the appointment of ICBC as Singapore's RMB clearing bank in February 2013.

- The offshore RMB market in Singapore has expanded, with a wide offering of RMB products, including deposits, bonds, derivatives, mutual funds, and trade financing.
- China and Singapore have set up cross-border RMB arrangements for Suzhou, Tianjin and Chongqing, enabling corporates in these areas to borrow from Singapore-based financial institutions as well as repatriate proceeds from bonds issued in Singapore.

But China comes to Singapore not only to do business in Singapore. It is to use Singapore as a launch-pad to do business in Southeast Asia.

In recent years, Chinese corporates and financial institutions have been rapidly growing their operations and investments in Southeast Asia. Singapore offers an effective gateway for their expansion into the region.

- There are some 6,500 Chinese companies in Singapore.
- Many of them, such as Lenovo, have set up regional finance and treasury centres here to take advantage of Singapore's banking and capital markets to finance their regional expansion.
- The seven Chinese banks in Singapore are also expanding their presence here to provide funding support for the activities of Chinese and regional corporates.

Singapore-based financial institutions have extensive networks in the individual ASEAN countries and, have proven to be trusted partners for Chinese entities venturing abroad.

- A recent example is China Minsheng Investment Corporation, one of the largest private investment firms in China, which set up an office in Singapore with the mandate to invest in companies in South-east Asia and North America. One of its first projects is the construction of an industrial park in Indonesia.
- Other Chinese companies, such as Baosteel, New Hope and Huaneng, have invested in Vietnam and the region through their Singapore subsidiaries, with financing support from local banks like DBS.

China-Singapore financial connectivity: the next chapter

The next chapter in China-Singapore financial partnership will go beyond co-operation on RMB business and the use of Singapore as an Asian gateway. It will be a more broad-based financial partnership that will provide deeper support to China's growing connectivity with Southeast Asia. Let me cite four concrete areas of partnership.

- Capital management
- Risk management
- Infrastructure financing
- Asset management

Capital management

Chinese enterprises have mostly relied on domestic sources of funds such as bank lending to finance their international expansion. Many Chinese companies have also listed in equity markets in the US, Hong Kong and Singapore.

But as Chinese companies grow their global presence, they will have to think harder about how best to raise capital and how best to make use of their capital by tapping into offshore markets.

First, bond markets offer a useful alternative to bank lending, especially for long-term funding. Deep capital markets, anchored by a large institutional investor base can help well-rated businesses to achieve efficient cost of funding. Chinese companies are becoming more active in Singapore's bond market.

- For instance, China Oilfields Services Limited successfully raised US$1 billion in Singapore last year, including a 10-year medium-term note of US$500 million.

Second, Chinese corporates with income-producing real estate and infrastructure assets could recycle their capital by securitising these assets through a trust vehicle.

- SGX saw its first China real estate investment trust or REIT last year, with Beijing Hualian Group raising close to S$400m through a REIT.

Similarly, Chinese banks can use loan securitisation to recycle bank capital and re-channel the funds to real economic activities back home.

- ICBC's opening of its Asia Pacific Shipping Finance Centre is a good example of this.
- The centre will help ICBC Singapore securitise its shipping and related loans originated in the Asia Pacific, by tapping the Singapore bond market.

Risk management

As Chinese corporates continue to venture abroad in Asia, they will confront a variety of risks. These risks need to be managed well.

First, there are the usual foreign exchange and interest rate risks.

- As the largest FX market in the Asia Pacific, Singapore offers Chinese corporates effective FX hedging solutions to manage their risk exposures.
- The Singapore Exchange has a strong suite of FX futures contracts, including Asian currencies, and the take-up rate has been strong.
- Many corporate treasurers have chosen Singapore for their regional treasury centres covering Southeast Asia, and even the Greater China region.

Second, some of the investments by Chinese corporates could be in locations that are vulnerable to natural disasters.

- Investors would need to take into account not only the immediate risk of loss due to a natural catastrophe but also the secondary impact on their supply chains and working capital.
- Singapore has a critical mass of specialty insurers who can provide appropriate cover against such natural catastrophe risk.

Third, infrastructure projects typically expose investors to significant political and credit risks.

- Such risks include defaults and insolvencies of trading partners, regulatory changes, expropriation, labour unrest, and acts of terrorism.
- As the largest centre for structured trade credit and political risk insurance in Asia, Singapore can provide Chinese banks and corporates comprehensive and tailored risk management solutions.

Infrastructure financing

China is playing an increasingly important role in helping regional economies with infrastructure development through its "One Belt One Road" initiative.

Chinese corporates and financial institutions can tap into Singapore's well-developed infrastructure financing ecosystem in the following ways.

- Leverage on the strong network of multilateral agencies, banks and institutional investors to access regional infrastructure deals.
- Deepen their expertise in project structuring, risk allocation, and loan documentation.
- Gain access to the network of local project sponsors who are traditionally more accustomed to dealing with local and global banks.

Asset management

China is one of the key markets for Singapore-based fund managers, both as an investment destination as well as a source of capital.

- There is strong interest from financial institutions here to tap Singapore's RQFII quota and offer investments with China exposures.
- Last week, Blackrock secured RMB 20 billion of approved RQFII quota in Singapore, which is the second largest quota granted to-date.

At the same time, the Singapore market offers globally diversified investment portfolios for Chinese pension funds, insurance companies, and individuals.

- There is a growing cluster of Chinese asset managers that are keen to set up in Singapore, attracted by our pan-Asian focus and broad base of international investors.
- They cover a broad spectrum of investments, ranging from traditional asset managers to hedge funds to private equity funds.

Conclusion

Let me conclude.

The biggest story for Asia in the last three decades has been the rise of China. Asia's biggest story in the next three decades will be the transformation of China.

It will not be an easy transition, as China deals with the challenges of debt, deflation, and demographics. There will be dislocations and bouts of volatility along the way, with spillovers into Asia. But if China successfully addresses its vulnerabilities and restructures its economy, it will pave the way for more sustained growth and a more advanced economy.

The new China that will emerge will open up new opportunities for Asian economies. The RMB will become more international and Chinese corporates and financial institutions more global. Singapore is well-positioned to partner Chinese companies in their regional journey and deepen China's connectivity to Asia through trade and investment. The next chapter of China-Singapore financial partnership will be exciting and rewarding.

I wish you fruitful discussions and a pleasant stay in Singapore. Thank you.